



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

September 16, 1998

MEMORANDUM FOR RAYMOND SMITH
DIRECTOR, MARKET SEGMENT & SPECIALIZATION
(CP:EX:CS:M)

Attn: Linda Hoffman

FROM: Kathleen Reed
Assistant to the Branch Chief, Branch 5
Passthroughs & Special Industries (CC:DOM:P&SI:5)

SUBJECT: Service's Authority to Examine Noncompliance Issues
Under § 42
SPR-116551-98

This memorandum responds to Linda Hoffman's recent telephone request for substantiation that the Internal Revenue Service and not any state or local housing agency has the responsibility to examine federal tax returns for noncompliance with the provisions of § 42.

We understand that Ms. Hoffman's request is the result of several examining agents in the Northern Florida District taking the position that because of the statutory and regulatory compliance monitoring responsibilities under § 42(m)(1)(B)(iii) of the Internal Revenue Code and § 1.42-5 of the Income Tax Regulations, state and local housing agencies have the responsibility to audit the federal tax returns of persons claiming the low-income housing tax credit for noncompliance issues under § 42. However, as stated in the preamble to § 1.42-5, the Service and not any state or local housing agency has this responsibility.

Section 42(m)(1)(B)(iii) provides that an allocation plan is qualified if it contains a procedure that the agency (or an agent or other private contractor of such agency) will follow in monitoring for noncompliance with the provisions of § 42 and in notifying the Internal Revenue Service of such noncompliance that such agency becomes aware of.

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Section 1.42-5 implements the requirements of § 42(m)(1)(B)(iii). The preamble to § 1.42-5 provides, in relevant part, that the Service bears the responsibility for determining whether a building owner has claimed the correct amount of credit each year and whether the building owner is subject to recapture. It is not the intent of these regulations to have [state and local housing] Agencies audit income tax returns. T.D. 8430, 1992-2 C.B. 14, 16 (emphasis added). Further, in response to a comment that the use of the term "auditing" in the proposed regulations is misleading because it implies that the state and local housing agencies are to audit the tax records of the owner of the building for the Service, the final regulations substituted the term "inspection." T.D. 8430, 1992-2 C.B. at 17.

Consequently, state and local housing agencies do not examine any low-income housing tax credit issue on federal tax returns. They merely bring noncompliance issues of which they become aware of to the attention of the Service, as they are statutorily mandated to do so. The Service, in the exercise of its discretionary authority to administer and enforce the provisions of the Code, performs the tax administration functions relating to the low-income housing tax credit (for example, by examination and audit based on information collected by the Service including but not limited to information reported by project owners and state housing agencies). Thus, the Service and not any state or local housing agency has the responsibility to examine federal tax returns for noncompliance with the provisions of § 42.

If you wish to discuss this matter further, do not hesitate to call me at (202) 622-3040.

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